



Economic Update

Committee on the Budget • Majority Caucus
U.S. House of Representatives
Jim Nussle, *Chairman*

309 Cannon House Office Building
Washington, DC 20515 • (202) 226-7270
James T. Bates, *Chief of Staff* • www.budget.house.gov

Volume 5, Number 6

13 July 2006

Tax Receipts Up, Budget Deficit Down in 2006

Overview

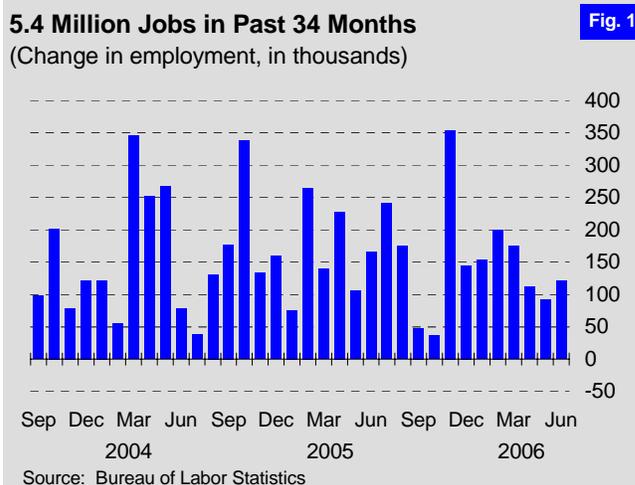
Another surge in Federal tax receipts provided further evidence of the economy's strength and caused a sharp reduction in the administration's deficit estimate for the current year. Mid-year tax receipts are up by 13 percent, compared with June of 2005, according to data released by the Congressional Budget Office [CBO]. Meanwhile, the Office of Management and Budget [OMB] projects 11-percent growth in receipts for all of 2006. Either way, the increases reflect substantial gains in corporate tax receipts – due to increased corporate profits – and indicate higher personal incomes as well.

Job growth in June increased for the 34th consecutive month, and unemployment stayed at 5-year low levels. Hours worked increased and average hourly wages rose strongly in June as well.

The Federal Open Market Committee [FOMC] raised interest rates a quarter-point in June, as it had at each of its previous 16 meetings. Although future actions will depend on incoming data, a softening in the housing market and decreased consumer spending are the most likely reasons that the streak will end soon.

Highlights

- CBO estimated that tax receipts grew by 13 percent through June, compared to the same point in time last year. Corporate taxes increased by \$52 billion (26 percent over last year), but most of the additional receipts came from individual income taxes, up by \$97 billion (14 percent).
- In June, 121,000 new jobs were created, reversing 3 months of successive declines in the rate of job growth. More than 5.4 million jobs have been created in the past 34 months, of which 1.9 million came in the past year alone. The unemployment rate stands at 4.6 percent, the lowest in more than 5 years, indicating that much of the



Blue Chip Economic Outlook, July 2006								
	2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Actual				Projected			
Real GDP Growth	3.8	3.3	4.1	1.7	5.6	2.8	2.9	2.8
Unemployment Rate	5.3	5.1	5.0	4.9	4.7	4.6	4.7	4.7
CPI Inflation	2.3	3.8	5.5	3.3	2.2	4.5	2.8	2.4
3-month Treas. Bill	2.5	2.9	3.4	3.8	4.4	4.7	5.1	5.2
10-year Treas. Note	4.3	4.2	4.2	4.5	4.6	5.1	5.3	5.3

slack in labor markets has been removed. Hourly earnings grew strongly in June, suggesting that labor market tightness may be feeding into wage growth.

- Even with some softening in the economy, the FOMC has continued trying to wring energy price inflation from the general price level. The committee increased the Federal funds rate to 5.25 percent at the end of June. Inflation, excluding volatile energy and food prices,

(continued on reverse side)

was an annualized 2.4 percent according to the Consumer Price Index [CPI], and an annualized 2.1 percent according to the Personal Consumption Expenditure [PCE] index. Both measures exceed the Fed's "comfort zone" of 1-percent to 2-percent inflation.

- Energy prices have climbed to record territory, as crude oil futures have closed above \$70 per barrel for most of the second quarter. Futures closed above \$75 per barrel last week, while the national average price of gasoline was \$3 per gallon. Market prices reflect both geopolitical fears as well as growth in gasoline consumption relative to last year.

Tax Receipts Up in 2006

Tax receipts increased by \$206 billion through June and can be expected to be up for the entire 2006 fiscal year, compared to fiscal year 2005 (which were themselves 15 percent higher than fiscal year 2004). While corporate income taxes led the 2005 rise, the increase this time around has come primarily from individual tax receipts. This diversification in tax receipt growth is an indication of the strength of the economy, where rising corporate profits as well as robust wage and salary growth have contributed to an improved top line for the Federal budget.

In the administration's *Mid-Session Review* of the budget, released on 11 July 2006, OMB predicts that the increased tax receipts will shave \$115 billion from this year's budget deficit, leaving a deficit total of \$296 billion for 2006.

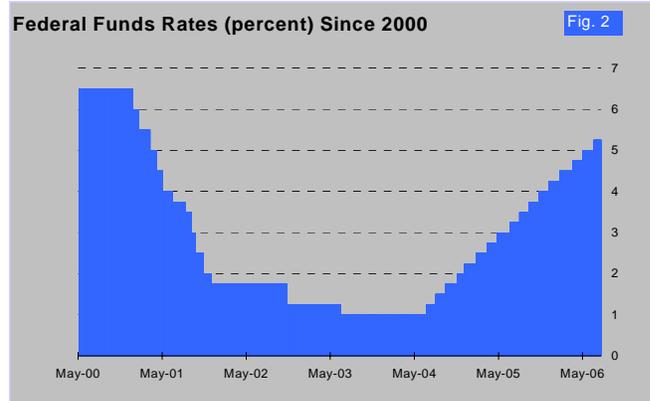
Job Creation Steadies

The 121,000 new jobs in June were more than the increases of the previous month, but remained about two-thirds the rate of monthly gains over the previous year. This demonstrates some softening in labor markets, as the economy notably lost construction and retail jobs and gained manufacturing jobs. Signs of overall weakness are scant, however, as initial claims by individuals for unemployment benefits have rarely crept over 310,000 per week (averaged over a 4-week period); sustained claims in excess of 400,000 are often cited as necessary for an increase in the unemployment rate.

The unemployment rate – 4.6 percent in June – has fallen by 1.7 percentage points since its recent peak of 6.3 percent in June 2003.

Federal Reserve Sustains Data-Dependent Policy

The Fed is struggling to keep double-digit energy and commodity price inflation out of the general price level, and thereby continue fostering sustainable growth and investment. The Fed has increased overnight rates in a sequence of 17 quarter-point hikes that began in June 2004, raising the rate from 1.00 percent to the current 5.25 percent. For August, financial markets currently see either an additional quarter-point or a pause as equally likely.



Energy Prices Remain High

Oil prices reached a record high last week on a combination of geopolitical fears and increasing demand for fuel. Analysts see a substantial "risk premium" on oil prices – some peg it at \$15 per barrel – due to fears about the outcome of militant action in Nigeria, the nuclear standoff between Iran and the West, and attacks on oil infrastructure in Iraq. But demand has not decreased notably. Gasoline consumption, for example, increased by 1.4 percent in the past 4 weeks, compared with the same period a year ago.

Upcoming Indicators

Inflation - The Consumer Price Index for June is scheduled to be released on *July 19*.

GDP - The first estimate of GDP growth for the 2nd quarter of 2006 is scheduled for release on *July 28*.

Employment - July employment and unemployment data are scheduled for release on *August 4*.

Federal Reserve - The Fed's next monetary policy meeting is scheduled for *August 8*.

Prepared by Jeffrey W. Hopkins
 Chief Economist